Statement of

The Honorable George Gekas
Former Congressman from the State of Pennsylvania

Before the

Subcommittee on Commercial and Administration Law
Committee on the Judiciary
U.S. House of Representatives

Hearing on H.R. 4019
Relating to State Taxation of Non-Resident Retirement Income

December 13, 2005

Mr. Chairman, Congressman Watt and distinguished Members of the Subcommittee:

Thank you for the opportunity to testify on H.R. 4019, a bill that would make it clear that existing federal law prohibits States from taxing the retirement income of any non-residents retirees. Congress needs to take action quickly to prevent States from undermining the common-sense legislation that was enacted in 1996 to prevent unfair and burdensome taxation. I commend you, Mr. Chairman, for introducing H.R. 4019 and for holding this hearing.

I understand that at least one large State is attempting to exploit an ambiguity in the 1996 law to argue that some non-resident retirees, namely non-resident retired partners, are not covered by the current-law prohibition on State taxation of non-resident retirees. As Chairman of the Subcommittee on Commercial and Administrative Law when Congress originally considered this issue, I can tell you this is simply not the case. The purpose of my testimony today is to provide some legislative background and history that will make this abundantly clear.

This issue first arose in the 1990s because some States, such California and New York, were imposing an income tax on retirement income of retired, non-resident individuals who worked in those States for part or all of their careers. At the time, several other States were discussing so-called "State source" taxes. There was no question that States had the Constitutional authority to impose such taxes, but Congress intervened because of the risks of double taxation and the complexity of multi-state compliance.

Largely due to the efforts of Congresswoman Barbara Vucanovich of Nevada, Congress ultimately passed the State Taxation of Pension Income Act of 1995 (Public Law 104-95). Public Law 104-95 is very straightforward. It provides that a State may not tax the retirement income of non-residents. The definition of retirement income includes income from a qualified retirement or annuity plan, such as an IRA or 401(k) plan, and income from a nonqualified deferred compensation plan. As Congresswoman Vucanovich noted when she introduced the legislation, it was purposefully designed to apply to all retirement income in order to be fair and treat all retirees equally.[1]

Although I believe that current law prohibits any State taxation of non-resident retirement income, I also understand that at least one State is arguing that there is a "loophole" in the statute that allows them to tax some non-resident retirees and not others, simply because they are non-resident retired partners rather than non-resident retired employees. I disagree. Therefore, it is important that Congress remove any

[1] Congressional Record, Extension of Remarks, January 5, 1995, p. E42.

doubt by enacting H.R. 4019. Otherwise, certain non-resident retirees could face costly litigation to fight aggressive taxation by some States -- a fight retirees would clearly win in court. In addition, if Congress does not act now, this issue could develop into a significant problem with other States.

The issue we are considering today stems from the definition of nonqualified deferred compensation plan contained in Public Law 104-95. When the decision was made during the legislative process to include nonqualified retirement plans, we referred to the definition of "nonqualified deferred compensation plan" found in the employment tax. At least one State has used this reference to argue that Public Law 104-95 only applies to nonqualified deferred compensation received by retired, non-resident employees and does not protect retired, non-resident partners. In reality, we used the reference to employment tax because, unlike qualified retirement plans, there is no reference to nonqualified retirement plans in the income tax code. The employment tax reference was meant to serve as a general, non-technical description of nonqualified deferred compensation plans. Had we fully understood the potential tax implications of including a FICA tax reference, we most certainly would have drafted the legislation differently.

Congress never intended to arbitrarily carve out certain groups of individuals from the protection of Public Law 104-95 even though the retirement income that they receive is in all other respects identical to the retirement income received by individuals enjoying the protection of Public Law 104-95. For example, Congress never intended to prohibit source State taxation of nonqualified retirement income of all employees, including highly compensated executives, but not of self-employed individuals, such

as partners. Moreover, Congress never intended for self-employed retirees to receive protection from source State taxation on their qualified retirement income (which Public Law 104-95 clearly covers) but not their nonqualified retirement income, while highly compensated executive retirees enjoy protection under Public Law 104-95 with regard to both types of retirement income. It is also difficult to see any policy reason for such a distinction.

In fact, Members of Congress who opposed Public Law 104-95 clearly believed the statute would apply to partners. The Dissenting Views section of the Committee report complains that "[b]y including nonqualified plans in the legislation, Congress will open broad new loopholes for lucrative compensation arrangements, such as golden parachutes, partnership buy-outs, and large severance packages."[2]

I believe it is clear from the statutory language, legislative history and purpose of the statute that Public Law 104-95 protects all non-resident retirees, regardless of whether they are a retired employee or a retired partner. However, because at least one large State is unwilling to recognize this, I strongly support enactment of H.R. 4019, which would shut down any possibility that States might be able to unfairly tax the retirement income of certain non-resident retirees, effective as of the date of enactment of Public Law 104-95 because it is consistent with Congressional intent.

Thank you again for the opportunity to testify today. I would be happy to answer any questions you may have.

[2] H. Rep. No. 104-389 at 16